

REPORT OF
FINANCIAL EXAMINATION

**FARMERS MUTUAL FIRE INSURANCE COMPANY
OF SHELBY COUNTY**

As Of
December 31, 2005



STATE OF MISSOURI
DEPARTMENT OF INSURANCE
JEFFERSON CITY, MISSOURI

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June 7, 2006
Shelbina, MO

Honorable W. Dale Finke, Director
Missouri Department of Insurance
301 West High Street, Room 530
Jefferson City, Missouri 65101

Dear Sir:

In accordance with your financial examination warrant, a full scope financial examination has been made of the records, affairs and financial condition of

Farmers Mutual Fire Insurance Company of Shelby County

hereinafter referred to as such or as the "Company." The Company's home office and principal place of business is located at 105 E. Chestnut, Shelbina, Missouri 63468; telephone number (573) 588-7648. This examination was conducted at the home office in Shelbina, Missouri. The examination began May 23, 2006, and concluded June 7, 2006.

SCOPE OF EXAMINATION

Period Covered

The Company was last examined by the Missouri Department of Insurance in 2001, for the period ending December 31, 2000. The current examination covers the period from January 1, 2001, through December 31, 2005, and was conducted by an examiner from the Missouri Department of Insurance.

Procedures

This examination was conducted using the guidelines set forth by the practices, procedures and applicable regulations of the Missouri Department of Insurance and statutes of the state of Missouri. Information provided by the Company's independent accountant was relied upon, including cash and securities confirmations, and the unearned premium calculation.

Comments – Previous Examination

The general comments and recommendations in the previous examination report and the subsequent action taken by the Company are listed below.

Comment: Growth and Experience of the Company

The Board should monitor the decline in the number of policies over the past few years and the decreased volume of premiums in 2000.

Company Response:

The Company monitored number of policies and reviewed rates on a regular basis.

Current Findings:

The number of policies in force has shown a slight decline while gross assessments have shown a steady increase and the Company has generated positive returns each year.

HISTORY

General

The Company was organized in October 1896 as Farmers Mutual Fire Association of Shelby County. On December 7, 1896, the Company received a Certificate of Incorporation from the Missouri Secretary of State. On October 21, 1972, the Company reorganized and changed its name to Farmers Mutual Fire Insurance Company of Shelby County, Missouri. The Company received a certificate of authority from the Missouri Department of Insurance and changed to an Extended Missouri Mutual Company (Sections 380.201 through 380.591 RSMo).

Management and Control

A board of nine directors provides oversight of the Company. Each director serves a three-year term with three directors elected each year. Directors are elected at annual member meetings held on the second Saturday in February. Special meetings of the members may be called by the Board of Directors at any time or upon petition of one-fourth of the members. Ten members constitute a quorum at annual member meetings and proxy voting is allowed.

The Board of Directors consisted of the following members as of December 31, 2005:

<u>Name/Address</u>	<u>Occupation</u>	<u>Term</u>
Bill G. Moore, President 5944 Highway HH Shelbina, MO 63468	Retired Farmer	2004 to 2007
Raymond Clem, Vice-President 408 South Broad Clarence, MO 63437	Teacher	2005 to 2008

Charles Kirby, Secretary/Treasurer 8124 Shelby 358 Shelbina, MO 63468	Farmer	2005 to 2008
Billie Echternacht 1390 Shelby 129 Leonard, MO 63451	Retired Farmer	2004 to 2007
Kenny Latimer 8960 Shelby 358 Hunnewell, MO 63443	Farmer	2003 to 2006
Clifford Marquette 568 Shelby 364 Bethel, MO 63434	Farmer	2005 to 2008
Marion Smoot 102 Central Ave. Shelbina, MO 63468	Farmer	2003 to 2006
George Wilt 5010 Shelby 2340 Shelbyville, MO 63469	Farmer	2004 to 2007
Billy Bob Wood 7167 Highway 151 Clarence, MO 63437	Farmer	2003 to 2006

In addition, Lordeen Request is the Company agent and manager.

Conflict of Interest

Signed conflict of interest statements were obtained from all directors. These statements did not disclose any conflicting situations and no apparent conflicts of interest were identified during this examination.

Corporate Records

Articles of Incorporation, Bylaws, and minutes from the annual meetings and board meetings were reviewed. The Company is following the guidelines established in the Articles of Incorporation and Bylaws. The Board meeting minutes indicated that the Board is adequately informed regarding the Company's operations. The Board formally acknowledged the previous examination report during its October 9, 2001 meeting. Attendance at the Board and annual meetings appears to be satisfactory.

FIDELITY BOND AND OTHER INSURANCE

The Company has acted to help minimize the risk exposure of the business. The Company has a fidelity bond totaling \$100,000 from Benchmark Insurers. This exceeds the minimum level recommended by the National Association of Insurance Commissioners. The Company has one agent and provides the errors and omissions coverage (aggregate limit of \$1,000,000) for that agent through Missouri Association of Mutual Insurance Companies (MAMIC Mutual). Directors and officers liability coverage, with an aggregate limit of \$2,000,000, is provided by MAMIC Mutual. The Company has a property and liability policy for its home office provided by Grinnell Mutual Reinsurance with limits of \$73,065 on the property and \$1,000,000 aggregate liability.

EMPLOYEE BENEFITS AND PENSION PLANS

The Company has three full-time employees. The Company's manager is also the agent for the Company and is compensated through commissions. All employees receive two weeks paid vacation and six days of sick leave. All three full-time employees receive health insurance. The Company has no retirement plan.

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory and Plan of Operations

The Company is licensed by the Missouri Department of Insurance to operate under Sections 380.201 through 380.591 RSMo (Extended Missouri Mutual Companies). The Company is authorized to write fire, windstorm, and liability coverages throughout the state but writes primarily in Shelby and surrounding counties. A single agent produces business for the Company and receives a 20% commission on all new and renewal premiums. The Company advertises in local newspapers and through various promotional activities in the community.

Policy Forms and Underwriting Practices

The Company uses policy forms from the Missouri Association of Mutual Insurance Companies (MAMIC) and the American Association of Insurance Services (AAIS). Inspections and underwriting are performed by the agent. The Company issues three-year renewable policies. All policies are issued with semi-annual payments, although the policyholder may elect to make annual payments.

Initial fire and wind claim reviews are performed by the Company's agent. All liability claims are adjusted by the reinsurer. The Company uses outside adjusters or inspectors on large or suspicious fire claims. Records of claim filings are kept in the policy file and are recorded in the computer claims system. The amount of the loss is determined and the claim paid when proof of loss is received.

GROWTH AND LOSS EXPERIENCE OF THE COMPANY

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Admitted Assets	2,915,615	3,012,009	3,282,083	3,490,976	3,647,849
Liabilities	113,980	128,350	216,501	217,910	216,411
Gross Assessments	527,654	551,642	571,415	594,330	613,364
Losses Incurred	274,867	352,242	198,225	235,628	569,549
Investment Income	139,618	110,735	96,334	90,477	111,256
Underwriting Income	48,888	(15,012)	96,594	124,602	67,193
Net Income	165,209	82,024	183,491	207,484	164,386
Policies In Force	1,217	1,180	1,163	1,152	1,115

These figures are based on data from annual statements provided by the Company. Losses incurred do not reflect any reinsurance recoveries. Overall, the Company's admitted assets have shown steady growth because of its ability to generate positive returns each year. The number of policies in force has shown a slight decline while premiums received have shown a steady increase.

REINSURANCE

Assumed

The Company does not assume any reinsurance.

Ceded

The Company has reinsurance through an agreement with Grinnell Mutual Reinsurance Company. Various larger risks (those in excess of \$500,000-\$750,000) are covered through facultative agreements with Grinnell. The remaining in force business is covered by the following agreements:

Individual Occurrence of Loss Limit Reinsurance Agreement This contract provides that the Company retain the first \$50,000 of loss (wind or fire), each risk, each occurrence. The premium for this coverage is charged at a monthly rate based on the adjusted gross fire risk in force per \$1,000 at the end of each month during the contract year.

Aggregate Excess Reinsurance Agreement This is an unlimited aggregate excess of loss agreement with an attachment point that is calculated yearly. The premium for this coverage is charged at a monthly rate based on the adjusted gross fire risk in force per \$1,000 at the end of each month during the contract year.

One Hundred Percent (100%) Quota Share Liability Reinsurance Agreement This agreement cedes all of the Company's liability premium to the reinsurer, who in turn, pays all

liability losses. The Company receives a ceding commission equal to 20% of the subject net written premiums.

One Hundred Percent (100%) Quota Share Earthquake Reinsurance Agreement This agreement cedes all the Company's earthquake insurance premium to the reinsurer, who in turn, is responsible for all earthquake losses. The Company's ceding commission is built into the formula of the premium that the Company pays.

ACCOUNTS AND RECORDS

The Company maintains financial records primarily on an automated system. Accounting records for premiums, claims and financial reporting are kept on a mutual insurance company software package from IMT, a software company in Des Moines, Iowa. Premium receipts are also manually recorded to a ledger. Claim documentation is kept in the policyholders' files.

Overall, the Company's accounting system appears to be adequate to meet management and financial reporting requirements. A public accounting firm, Van de Ven, LLC, is used to prepare the Company's financial statements, tax returns and annual statement. The annual statement was prepared on an accrual basis and included an unearned premium reserve.

FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of the Company as of December 31, 2005, and the results of operations for the year then ended. Any examination adjustments to the amounts reported in the annual statement and/or comments regarding such are made in the "Notes to the Financial Statements" which follow the financial statements. (The failure of any column of numbers to add to its respective total is due to rounding or truncation.)

There may have been additional differences found in the course of this examination, which are not shown in the "Notes to the Financial Statements." These differences were determined to be immaterial concerning their effect on the financial statements, and therefore were only noted in the workpapers for each individual annual statement item.

ADMITTED ASSETS

Bonds	\$ 1,551,370
Stocks	500
Real Estate	35,973
Cash on Deposit	1,844,045
Reinsurance Recoverable on Paid Losses	161,033
Computer Hardware	2,552
Accrued Interest Receivable	29,309
Premium Balances Uncollected	18,524
Prepaid Exense	4,543
Total Assets	<u>\$ 3,647,849</u>

LIABILITIES, SURPLUS AND OTHER FUNDS

Losses Paid	\$ 1,115
Ceded Reinsurance Payable	11,233
Unearned Premium	187,775
Accounts Payable	2,169
Misc Write In Liabilities	14,119
Total Liabilities	<u>\$ 216,411</u>
Guaranty Fund (Note 1)	150,000
Other Surplus	3,281,438
Total Policyholder Surplus	\$ 3,431,438
Total Liabilities and Surplus	<u>\$ 3,647,849</u>

STATEMENT OF INCOME

Net Assessments (Premiums)	\$ 458,253
Reinsurance Commissions	12,536
Net Losses	(231,096)
Underwriting Expenses	(172,500)
Net Underwriting Income (Loss)	\$ 67,193
Other Income	67
Net Investment Income	111,256
Federal Income Tax	(14,130)
Net Income	\$ 164,386

Policyholder Surplus December 31, 2004	\$ 3,273,066
Net Income (reported by the Company)	164,386
Change in Non-Admitted Assets	(6,014)
Policyholder Surplus, December 31, 2005	\$ 3,431,438

NOTES TO FINANCIAL STATEMENTS

There were no notes to the financials.

EXAMINATION CHANGES

There were no examination changes made during this examination.

GENERAL COMMENTS AND/OR RECOMMENDATIONS

There were no general comments or recommendations made during this examination.

SUBSEQUENT EVENTS

There were no significant subsequent events.

ACKNOWLEDGMENT

The assistance and cooperation extended by the directors, officers and employees of the Farmers Mutual Fire Insurance Company of Shelby County in the course of this examination is hereby acknowledged and appreciated.

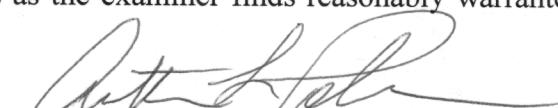
VERIFICATION

State of Missouri)

) ss

County of St. Louis City)

I, Arthur Palmer, on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only facts appearing upon the books, records or other documents of the Company, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs and such conclusions and recommendations as the examiner finds reasonably warranted from the facts.

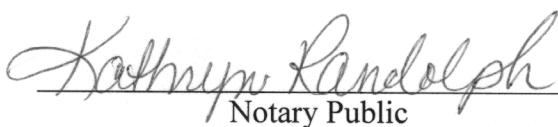


Arthur Palmer, CFE
Financial Examiner
Missouri Department of Insurance

Sworn to and subscribed before me this 15th day of August, 2006.

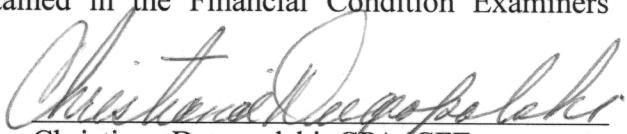
My commission expires:

March 4, 2008


Kathryn Randolph
Notary Public

SUPERVISION

The examination process has been monitored and supervised by the undersigned. The examination report and supporting workpapers have been reviewed and approved. Compliance with NAIC procedures and guidelines as contained in the Financial Condition Examiners Handbook has been confirmed.


Christiana Dugopolski, CPA, CFE
Audit Manager
Missouri Department of Insurance